

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**MAJOR ACCOUNTING DEFICIENCIES IN THE DEFENSE
BUSINESS OPERATIONS FUND IN FY 1994**

Report No. 95-294

August 18, 1995

20000107 063

Department of Defense

AQI00-04-0873

Additional Copies

To obtain additional copies of this report, contact the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch, Audit Planning and Technical Support Directorate, at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

Inspector General, Department of Defense
OAIG-AUD (ATTN: APTS Audit Suggestions)
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

DoD Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of writers and callers is fully protected.

Acronyms

DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
GAO	General Accounting Office
IG	Inspector General
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
USD(C)	Under Secretary of Defense (Comptroller)



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



August 18, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE

SUBJECT: Audit Report on Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994 (Report No. 95-294)

We are providing this report for your information and use and for the use of Congress. It identifies and summarizes the major deficiencies in the Defense Business Operations Fund's accounting systems that prevent timely development and reliable presentation of the Fund's financial statements. Where applicable, it also identifies corrective actions taken or under way to eliminate these deficiencies. We considered management comments on a draft of this report in preparing our final report.

This report contains a summary finding and no recommendations. No further management comments are required.

The courtesies extended to the audit staff are appreciated. Questions on the audit should be directed to Mr. Raymond D. Kidd, Audit Program Director, at (703) 604-9110 (DSN 664-9110), or Mr. John M. Seeba, Audit Project Manager, at (703) 604-9134 (DSN 664-9134). See Appendix J for the report distribution. A list of team members is inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, Department of Defense

Report No. 95-294
(Project No. 4FH-2010.01)

August 18, 1995

Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994

Executive Summary

Introduction. The Chief Financial Officers Act of 1990 requires an annual audit of the financial statements of trust and revolving funds, such as the Defense Business Operations Fund (the Fund). The Fund was established as a revolving fund in FY 1992 and consists of various business areas. Operational and cost management responsibilities rest with the Military Departments and Defense agencies. The FY 1994 Defense Business Operations Fund Statement of Financial Position identified assets of \$102.6 billion and liabilities of \$17.4 billion. For FY 1994, as in previous years, we have been unable to render an opinion on the financial statements because of significant deficiencies in the internal control structure and significant instances of noncompliance with laws and regulations. This audit report addresses the significant accounting and financial management deficiencies. We plan to issue a similar report each year to provide the status of corrective actions by DoD on identified deficiencies.

Audit Objectives. The objective of the audit was to identify and summarize the Defense Business Operations Fund's major accounting deficiencies that prevented the timely development, reliable presentation, and effective use of the Fund's financial statements.

Audit Results. We identified major accounting and financial management deficiencies in the Fund. Those deficiencies prevented the timely development, reliable presentation, and effective use of the financial statements. The deficiencies identified during the audits of the Fund can be grouped into the following major categories:

- o accounting systems' characteristics,
- o policy guidance,
- o Property, Plant, and Equipment,
- o inventory valuation and classification of accounts, and
- o personnel.

Identified problems corresponded to approximately 23 percent of total assets and 5 percent of total revenues. These deficiencies resulted in auditor-recommended adjustments of \$53.6 billion to the Defense Business Operations Fund's FY 1994 financial statements and the supporting accounting records. Corrective actions affecting \$19.9 billion of the recommended adjustments have been implemented. However, the actions necessary to remedy many of these deficiencies require long-term planning and commitment. The Fund's financial statements will be of little use unless the weaknesses in the internal control structure are eliminated. Of greater importance, however, is that DoD management lacks sound information from financial reports,

including but not limited to annual financial statements, to use in decisionmaking. See Part I for a discussion of the audit results.

Summary of Recommendations. This report contains no recommendations because numerous recommendations were made in the financial statement audit reports listed in Appendix B. It is intended to provide information to Congress, the Office of Management and Budget, and DoD managers and to assist them in identifying and remedying significant accounting deficiencies in the Defense Business Operations Fund. Management should:

- o implement the DoD Standard General Ledger in all interim migratory, migratory, and new accounting systems;
 - o improve documentation and audit trails;
 - o implement reasonableness and analytical edit checks for internal control;
 - o develop and provide accounting guidance, ensure distribution to all users, and follow up to ensure consistent implementation;
 - o improve accounting for Property, Plant, and Equipment;
 - o improve accounting for inventory valuation and classification of accounts;
- and
- o develop and improve documentation on critical accounting processes to assist personnel in preparing financial information.

Management Comments. We issued a draft of this report on June 30, 1995, and received comments from the Under Secretary of Defense (Comptroller). The Under Secretary of Defense (Comptroller) generally concurred, stating that on balance, the report fairly presented conditions that existed within the Defense Business Operations Fund during the period of the audit. See Part III for the complete text of the comments. No further comments are required.

Table of Contents

Executive Summary	i
--------------------------	----------

Part I - Audit Results

Audit Background	2
Audit Objectives	3
Audit Assistance	4
Defense Business Operations Fund Financial Accounting	5

Part II - Additional Information

Appendix A. Scope and Methodology	21
Appendix B. Prior Audits and Other Reviews	22
Appendix C. Financial Statement Reporting Structure for the Defense Business Operations Fund	30
Appendix D. Summary of Work Performed by Others	31
Appendix E. Account Deficiencies Identified	33
Appendix F. Status of Deficiencies	34
Appendix G. Internal Control Structure	45
Appendix H. Key Accounting Requirements	46
Appendix I. Organizations Visited or Contacted	48
Appendix J. Report Distribution	49

Part III - Management Comments

Office of the Under Secretary of Defense (Comptroller)	54
--	----

List of Figures

Figure 1. Accounting Deficiencies by Major Categories	6
Figure 2. Asset and Liability-Related Deficiencies in Relation to Total Assets and Total Liabilities	7
Figure 3. Accounting Systems' Deficiencies	10
Figure 4. Problems with Guidance	14
Figure 5. Deficiencies in Account Valuation and Classification	17

Part I - Audit Results

Audit Background

Chief Financial Officers Act of 1990. The Chief Financial Officers Act of 1990 requires an annual audit of financial statements for revolving funds, including the Defense Business Operations Fund (DBOF, the Fund). Preparation of the financial statements is the responsibility of the Defense Finance and Accounting Service (DFAS). The information in the statements is the joint responsibility of the DoD Components and the DFAS. The responsibility of the Inspector General (IG), DoD, is to audit and express an opinion on the financial statements. This report complements our opinion report on the DBOF financial statements (Office of the Inspector General, Department of Defense, "Defense Business Operations Fund Consolidated Statement of Financial Position for FY 1994," Report No. 95-267, June 30, 1995). Appendix C outlines the financial statement reporting structure for the DBOF.

Defense Business Operations Fund History. The DBOF was created by Congress on October 1, 1991, by combining the Defense- and Service-owned stock and industrial revolving funds. The DFAS, the Defense Commissary Agency, and two Defense Logistics Agency (DLA) functions (the Defense Reutilization and Marketing Service and the Defense Industrial Plant and Equipment Center) are also part of the DBOF. The Defense Technical Information Center, part of DBOF through the end of FY 1994, was removed at the beginning of FY 1995.

Operational and cost management responsibilities rest with the Military Departments and Defense agencies. Prior to FY 1995, the Under Secretary of Defense (Comptroller) (USD[C]) was responsible for the management of the Fund's cash. As of February 1, 1995, the USD(C) transferred responsibility for the management of DBOF cash to the DoD Components¹. The DBOF reported revenues of \$80 billion, expenses of \$83.2 billion, and assets of \$102.6 billion on its consolidated financial statements for FY 1994.

DBOF Purpose. The purpose of the DBOF is to reduce the cost of business services by first improving financial information and establishing more consistent policies and systems for cost accounting, and then using the information in decisionmaking. The goals of the DBOF are to:

- o foster a businesslike buyer-seller approach that increases cost awareness among decisionmakers,
- o reduce requirements for working capital,

¹The House Defense Authorization Bill for FY 1996 reversed this decision; however, a final decision by the Senate and House Conference Committee is still pending as of our report date.

- o improve cash control and reduce required cash balances, and
- o provide a framework for standardizing business processes and the financial practices of similar business activities.

DBOF Improvement Plan. In 1993, the Secretary of Defense conducted a comprehensive review of all aspects of the DBOF. The review included an examination of policies and procedures, the information available to the DBOF business managers, and the methods used to budget and execute the DBOF financial plan. As a result of the review, significant changes were recommended to improve the DBOF financial management systems, guidance, and training.

DBOF Progress Report. The February 1, 1995, "Defense Business Operations Fund Progress Report" discussed several actions taken as a result of the DBOF Improvement Plan. Specifically, a DBOF Corporate Board (the Board) was established to develop and review Fund guidance. The following subcommittees were instituted under Board direction:

- o a subcommittee to address the immediate development of important guidance;
- o a subcommittee to make cost-reduction recommendations to DBOF providers; and
- o a subcommittee to develop the requirements for business area performance reviews and to present information on financial and performance effectiveness to the Board.

The USD(C), through the Board, has issued decision papers on "Military Pricing," "Major Real Property Maintenance and Repair," "Cash Management," "Capital Equipment Purchasing," "Mobilization Costs and Policy," "Replacement Inventory," "Inventory Revaluation," "Net Operating Results," and "Interim Migratory System Selection." Other policies and procedures are under development.

Audit Objectives

The objective of this audit was to identify and summarize the major accounting and financial management deficiencies preventing the timely development, reliable presentation, and effective use of the DBOF financial statements. See Appendix A for the audit scope and methodology. See Appendix B for prior audit coverage related to the audit objectives.

Audit Results

Audit Assistance

We relied on audits performed by the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency. See Appendix D for specific areas and the scope of information reviewed by those audit organizations. The information presented in this report is a summary of the most significant deficiencies reported by the IG, DoD, and the Service audit organizations.

Defense Business Operations Fund Financial Accounting

The DBOF has not been able to prepare financial statements that fairly present the financial position of the Fund since its establishment in 1991. The financial statements prepared are untimely, unreliable, inconsistent, and inaccurate. This situation has been primarily caused by the numerous unlinked financial accounting and nonfinancial systems that are unable to compile and report financial information. These systems were developed prior to the formation of the DBOF and before the consolidation of accounting and finance activities into the DFAS. Generally, these systems were designed without consideration of accounting principles, such as accrual-based accounting, that are used to prepare financial statements or the DoD Standard General Ledger. Insufficient guidance and ineffective use of personnel have also hindered the production of meaningful DBOF financial statements. As a result, Congress and DoD managers have not been able to effectively use the DBOF financial statements and underlying systems for management oversight. More importantly, the unauditable financial statements are symptomatic of the inadequate internal control structure within the DBOF that negatively impacts day-to-day operations. We have issued disclaimers of opinion for the past 3 years on the DBOF Consolidated Financial Statements.

Accounting and Financial Management Deficiencies

Many of the deficiencies identified during audits can be grouped into a few broad categories that materially affect the financial statements:

- o accounting systems' characteristics;
- o overall management issues, including:
 - guidance;
 - Property, Plant, and Equipment (PP&E);
 - inventory valuation and classification of accounts; and
 - personnel.

Defense Business Operations Fund Financial Accounting

This classification of deficiencies grew out of issues identified during our FY 1994 annual audit of the DBOF financial statements. We identified 190 accounting problems, resulting in auditor-recommended adjustments totaling approximately \$53.6 billion. Appendix E matches several account deficiencies with specific accounts. Although corrective actions, approximating \$19.9 billion of the recommended adjustments, have been accomplished in many of these areas, significant problems remain. Figure 1 shows the number of deficiencies and the monetary amount associated with each. Figure 2 shows asset-related account deficiencies in relation to total DBOF assets (\$23.4 billion out of \$102.6 billion) and liability-related deficiencies in relation to total DBOF liabilities (\$5.5 billion out of \$17.4 billion). Appendix F shows which organization identified the deficiency, a description of the deficiency (including some of the smaller deficiencies noted), the amount, and the status of corrective actions. Of potentially greater concern is the significant number of adjustments that DFAS must make in addition to those identified by audits.

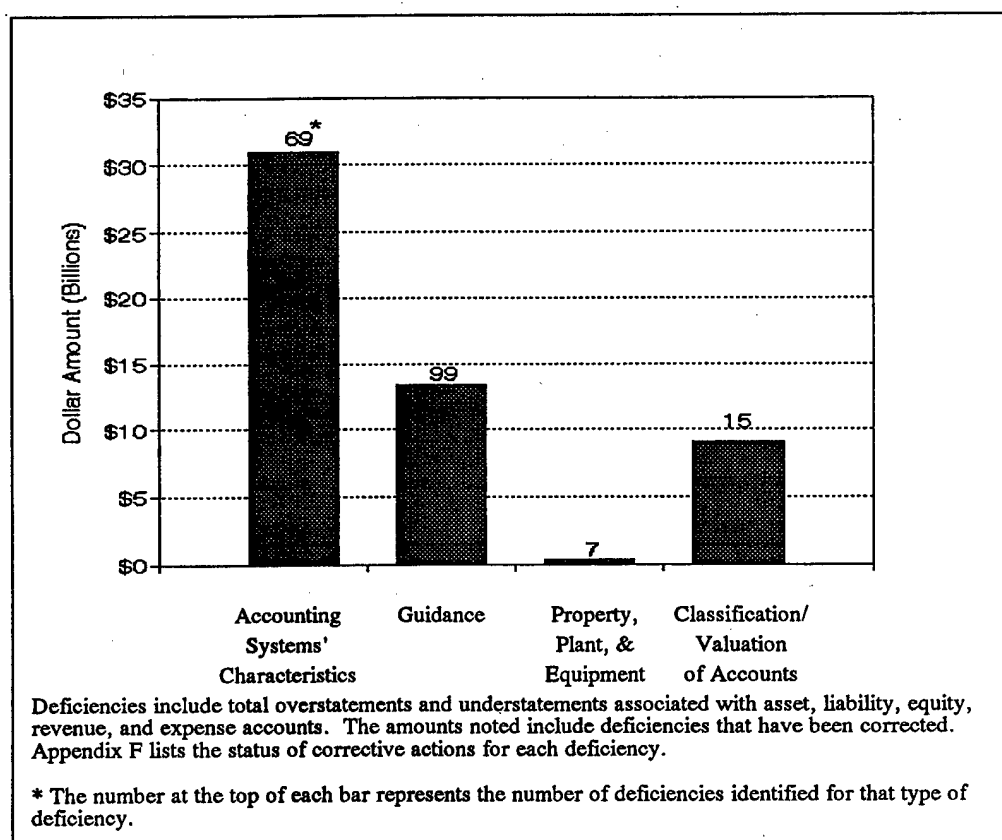


Figure 1. Accounting Deficiencies by Major Categories

Defense Business Operations Fund Financial Accounting

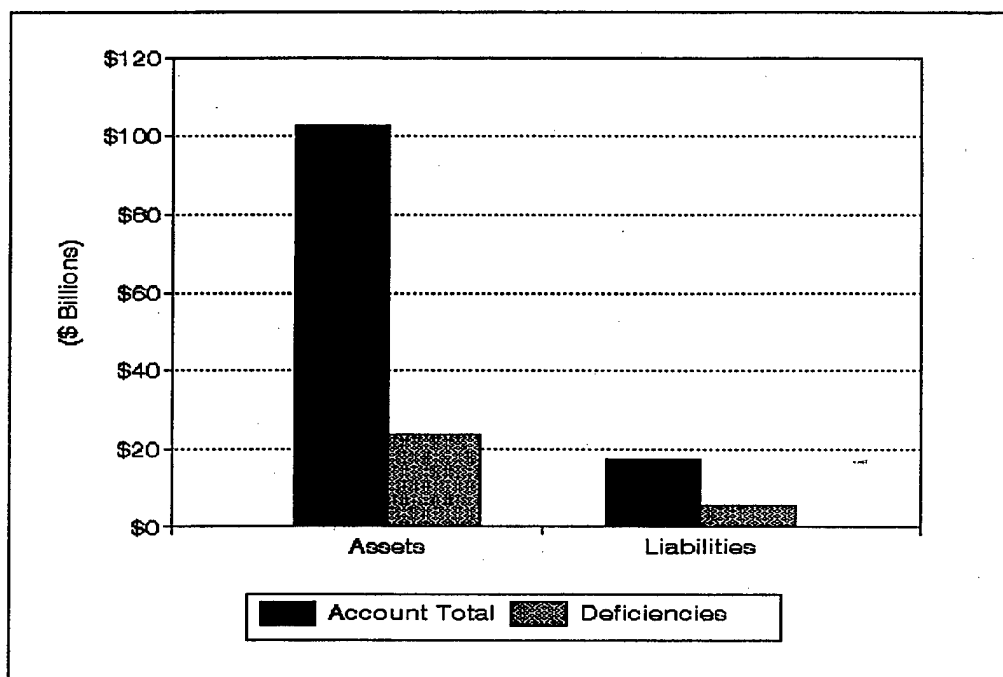


Figure 2. Asset- and Liability-Related Deficiencies in Relation to Total Assets and Total Liabilities

This report discusses significant internal control and other deficiencies that affected the collection and preparation of reliable financial information for use by management. The deficiencies relate to an overall inadequate internal control structure. The "Codification of Statements on Auditing Standards," §319.06 through §319.11, describes the elements of an internal control structure that management should use to achieve its control objectives. An internal control structure consists of the control environment, the accounting systems, and control procedures. Each of these elements contributes to ensuring adequate control over the integrity and validity of information produced by an organization. Appendix G describes in more detail the composition of an internal control structure. Without an adequate internal control structure, management has little chance of achieving its objectives in an effective and economical manner.

Accounting Systems' Characteristics

The DBOF accounting and financial systems compile information in an inefficient and unreliable manner. As noted in several audit reports, specific accounting characteristics in the DBOF accounting and financial systems hindered the manipulation of relevant data and prevented the effective development and use of financial statements. Moreover, little integration exists

Defense Business Operations Fund Financial Accounting

among the approximately 80 systems used to produce accounting documents for the DBOF. The total monetary value associated with these 69 deficiencies approximated \$31 billion. Distinctive characteristics of the DBOF accounting systems in which deficiencies existed, and which are integral parts of a properly functioning accounting system, include:

- o standard general ledger,
- o documentation and audit trails,
- o intrafund transactions,
- o reasonableness and analytical edit checks, and
- o footnotes.

Standard General Ledger. A major obstacle to the development and use of reliable financial statements is the lack of a universally implemented standard general ledger. We believe that the DBOF financial statements will not be fairly presented until the DoD implements a transaction-driven, integrated accounting system based on standard general ledger accounting. The U.S. Government Standard General Ledger was issued in 1986 by the Office of Management and Budget (OMB). However, almost 10 years later, DoD has still not made satisfactory progress in implementing the standard general ledger in accounting systems. A universally implemented standard general ledger will ensure that all DoD accounting and finance offices use the same accounts as the basis for their financial statements. DoD audit organizations and the General Accounting Office (GAO) support implementing a uniform DoD-wide standard general ledger. DoD financial managers, from executives to staff accountants at field finance activities, have endorsed this concept. To be fully effective, a uniform standard general ledger must be implemented at all levels where accounting transactions are performed. However, to date, DoD has relied on crosswalks in an attempt to recategorize data in the form of the DoD Standard General Ledger, as summarized below.

DoD requires the use of its standard general ledger for the management of data and the development of financial reports. The DoD Financial Management Regulation, DoD 7000.14-R, Volume 1, May 1993, states that an accounting system shall "provide maximum accounting and general ledger control through the use of the DoD Standard General Ledger." At present, however, the DoD Standard General Ledger is only partially implemented in a few DoD accounting systems. Since many of the accounting systems generally cannot accumulate data in the accounts required by the DoD Standard General Ledger, crosswalks have been implemented to translate the 15 different DBOF general ledgers to the DoD Standard General Ledger. A recent GAO review and our review suggest that these crosswalks may not be sufficient. A January 24, 1995, "DoD Auditability Self-Assessment" acknowledged that basic DoD financial reports are not completely or adequately derived from existing general ledger and subsidiary records. Further, the internal control weakness summaries issued for the DoD Internal Management Control Plan for FYs 1993 and 1994 have

Defense Business Operations Fund Financial Accounting

acknowledged that the lack of a universally implemented standard general ledger is a DoD-wide material weakness.

DFAS has proposed a two-phased strategy to correct the DBOF accounting systems and allow for the development of fairly presented financial statements. The first phase involves selecting and implementing modified Service-unique accounting systems as interim migratory systems. The second phase will involve selecting and implementing one or more standardized migratory accounting systems throughout the DBOF. However, a recent GAO audit has been critical of the timeliness of the DFAS plan to implement interim migratory systems. The initial deadlines for implementation of the interim migratory systems have not been met, although in some cases, new timeframes for implementation have been established. A significant hindrance to implementation exists because DoD accounting systems contain various general ledger structures developed by the Military Departments to meet their needs. Nevertheless, although implementation of the DoD Standard General Ledger is an action item in the 1993 DBOF Improvement Plan, the importance of a universally implemented standard general ledger cannot be overemphasized and should remain a high priority of senior DoD leadership.

Documentation and Audit Trails. Insufficient documentation and poor audit trails characterized many DBOF accounting and financial systems. As shown in Figure 3, audit reports identified \$15.8 billion associated with 40 documentation deficiencies. Missing or improper documentation slows the accounting process and can result in unsupported or inaccurate accounting transactions, with adverse consequences for financial statement preparation and the fairness of presentation of account balances. Some of the reasons for the widespread documentation problems were insufficient internal controls and noncompliance with established controls due to nonexistent or incomplete procedures, deficiencies in training, and obsolete accounting systems.

The USD(C) acknowledged in its "Auditability Self-Assessment," January 24, 1995, that nonexistent or partially documented audit trails have contributed to the compilation of unreliable financial data and have made system-wide accounting deficiencies worse. In its FY 1994 Annual Statement of Assurance under the Federal Managers' Financial Integrity Act, DFAS included incomplete audit trails and poor documentation in its designated high-risk areas. DFAS also included improved audit trails as 1 of its 13 key accounting requirements to be implemented in all interim migratory systems. DoD Regulation 7000.14-R, "Financial Management Regulation," Volume 1, May 1993, states that key accounting requirements are requirements of the GAO, the OMB, the Department of the Treasury, and the DoD with which an accounting system must reasonably comply. DFAS Headquarters uses key accounting requirements for cyclical reviews of DoD accounting systems. Appendix H provides a description of the 13 key accounting requirements used by DFAS.

Defense Business Operations Fund Financial Accounting

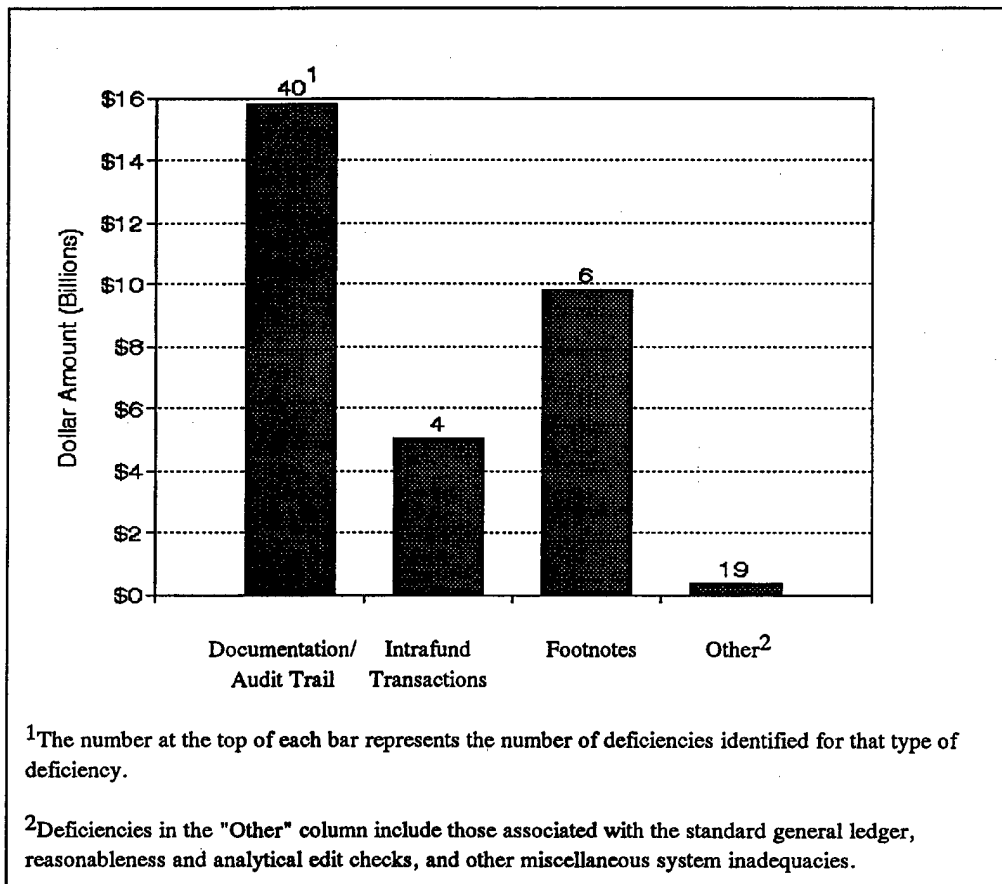


Figure 3. Accounting Systems' Deficiencies

DoD audits have consistently revealed the failure of DoD and Service managers to adequately document accounting transactions at all levels, from local finance offices to DFAS centers. Some of the major documentation issues noted during this year's audits included the following.

- o At the DFAS Indianapolis Center, Indianapolis, Indiana, 14 of the 53 DBOF manual general ledger adjustments, valued at \$5.4 billion, and 2 of the 8 journal vouchers, valued at \$5.5 billion, lacked audit trails and needed additional documentation.

- o Defense Accounting Office personnel at Scott Air Force Base, Illinois, did not record accurate account balances on the March 31, 1994, trial balance, resulting in \$1.4 billion of unsupported entries and accounting errors in monthly trial balances.

- o Personnel at the DFAS Denver Center, Denver, Colorado, did not adequately support a journal voucher for \$275 million for the net treasury balance and cumulative refund general ledger accounts.

Defense Business Operations Fund Financial Accounting

- o The five Air Force Air Logistics centers recorded \$207.9 million as Accounts Receivable without supporting documentation on the April 30, 1994, trial balance.

- o The DFAS Columbus Center, Columbus, Ohio, failed to adequately account for \$511.2 million in undistributed collections in the stock fund general ledger. This included \$349.4 million in undistributed collections at DLA Headquarters and a negative \$161.8 million in undistributed collections at other DLA Supply Management entities.

- o DFAS accounting offices lacked documentation for \$803 million of estimated Navy DBOF collections in FY 1994.

Preparation of the financial statements is excessively reliant on manual adjustments, and will remain inadequate as long as significant documentation problems continue. These problems can be largely mitigated by improvements in policies and procedures composing the internal control structure. The three critical elements composing an adequate internal control structure are discussed in Appendix G. Such improvements should not be deferred until full implementation of interim migratory systems for the DBOF.

Intrafund Transactions. Inadequate accounting for intrafund transactions contributed to significant distortions on the financial statements. Figure 3 shows \$5 billion associated with four intrafund transaction deficiencies. Intrafund transactions occur when sales are made or services are rendered to an entity within the same fund. They should be eliminated when preparing consolidated financial statements, since they involve funds moving only within the DBOF. In several situations, the mechanisms used to track and account for these transactions were nonexistent or only partially developed.

For example, the DFAS Cleveland Center lacked policies and procedures that would accurately identify non-Navy collections and disbursements for the DBOF. Only one accountant at the DFAS Cleveland Center had the corporate knowledge to identify and track intrafund transactions at Cleveland. This knowledge was not written down or understood by other employees. Moreover, the Navy did not include the required "Intrafund Eliminations" footnote in its FY 1994 Navy DBOF Consolidating Financial Statements. Because no procedures explained how to collect data for the Navy's footnote, the DoD DBOF Consolidated Financial Statements were overstated by at least \$3.2 billion for collections and \$1.4 billion for revenues.

Additionally, in a footnote to its financial statements, the DLA stated that it had not separately identified DBOF intrafund transactions for any of its business areas. Thus, the DBOF Consolidated Financial Statements do not reflect the required elimination of intrafund transactions within the DLA. Also, the DFAS Denver Center based its eliminating entry for intrafund accounts receivable and accounts payable on insufficient data. As a result, the adjustment made to eliminate intrafund accounts payable is unauditable and may not be correct. The DFAS Indianapolis Center made intrafund eliminating entries to the Army Statement of Operations, but did not make similar entries to the Statement of Financial Position. Without intrafund eliminating entries to the Statement of

Defense Business Operations Fund Financial Accounting

Financial Position, the overall financial statements are inconsistent and could be misleading. Moreover, the DFAS Indianapolis Center incorrectly eliminated \$420 million in transactions between the Army and other non-Army DBOF activities in the Army DBOF statement. These amounts should have been included in the Army's statement and eliminated from the overall DBOF statement. The DFAS Indianapolis Center corrected the \$420 million intrafund transaction error before the Army financial statements were issued.

DoD auditors, accountants, and financial managers attributed the inability to identify intrafund adjustments to a lack of official accounting guidance. They believed that the "DoD Guidance on Form and Content of Agency Financial Statements" did not provide adequate instructions for preparing intrafund eliminating adjustments. DoD Regulation 7000.14-R, "Financial Management Regulation," Volume 11B, December 1994, will be revised to include a chapter on accounting for intrafund transactions. Moreover, the May 4, 1995, DBOF management representation letter acknowledged that because of faulty accounting systems and a lack of guidance, intrafund transactions in the FY 1994 financial statements could not be determined. Until the issuance and full implementation of comprehensive guidance for intrafund transactions, DBOF financial statements will remain distorted and have little value for DoD managers. Such guidance can be implemented without awaiting the DBOF interim migratory accounting systems.

Reasonableness and Analytical Edit checks. Several DFAS centers did not have in place or fully use automated reasonableness and edit checks. These checks are used to ascertain the correctness and reasonableness of transactions and to detect abnormal general ledger balances reported by the field accounting activities. Failure to use reasonableness and edit checks results in incorrect financial statements and excessive time and effort expended to correct avoidable accounting problems. In our view, avoidance of accounting errors through an improved internal control structure is absolutely critical to financial statement presentation.

In IG, DoD, Report No. 94-168, "Defense Finance and Accounting Service Work on the Army FY 1993 Financial Statements," July 6, 1994, auditors at the DFAS Indianapolis Center reported a \$2.2 billion error in the 1992 Army DBOF financial statements regarding Inventory Not Held for Sale. This error could have been avoided if reasonableness checks had been in place.² Also, the DFAS Cleveland Center lacked an organized process for reviewing general ledger balances and line items on the financial statements for significant discrepancies. The DFAS Denver Center installed a computer program that used predetermined parameters to screen general ledger balances submitted from field offices, and notified management of imbalances. If an unreasonable imbalance existed, an accountant contacted the transmitting field office to resolve the problem.

In recent months, the DFAS Indianapolis Center has established procedures for edit and reasonableness checks of general ledger account balances and line items

²This amount was not included in the total of deficiency amounts for FY 1994.

on the financial statements. However, while the edit checks appeared to be working, the reasonableness checks were not being used effectively because the DFAS Indianapolis Center has not implemented procedures that require abnormal general ledger account balances to be adequately researched and resolved. This type of incomplete implementation of sound accounting practices plagues the DBOF.

Reasonableness and edit checks, especially if automated, provide inexpensive and easy techniques for discovering irregular balances. These checks would point to possible erroneous balances and allow timely research and correction of problems before development of the financial statements.

Footnotes. Footnote disclosures to the financial statements issued by the DFAS centers did not provide accurate overviews and supplemental financial information. This resulted from a variety of causes, including failure of the "DoD Guidance on Form and Content of Agency Financial Statements" to include all information required by the Statement of Federal Financial Accounting Standards Number 3, "Accounting for Inventory and Related Property," and OMB Bulletin No. 94-01, "Form and Content of Agency Financial Statements"; the incorrect application of the DoD guidance; inaccurate wording or unclear explanation of footnotes; an inability to trace dollar values; and poor documentation. Footnote 8 of the Air Force DBOF Consolidated Financial Statements indicated that \$9.5 billion of inventory was excess, obsolete, and unserviceable; the correct amount was approximately \$101 million. Thus, inaccurate or unclear footnotes may present a distorted view of line items to readers of the financial statements.

Overall Management Issues

We also identified deficiencies in the overall management of the DBOF accounting and finance systems. Major weaknesses, totaling \$13.3 billion, existed with regard to DBOF policies, procedures, and personnel. Inadequate guidance and personnel problems contributed to perpetuation of unreliable financial statements and also are considerable obstacles to implementation of a sound internal control structure. Additionally, we noted deficiencies in the material areas of PP&E and the valuation and classification of inventory and other accounts. Identified weaknesses in these accounts, which resulted in \$9.3 billion in auditor-recommended adjustments, materially affect financial statement preparation because of their large values in relation to total assets.

Guidance. Many accounting problems at DoD activities and on DBOF financial statements were directly attributable to deficient DBOF guidance. Audits identified 99 problems, resulting in auditor-recommended adjustments totaling \$13.3 billion, that were attributable to deficient guidance, as shown in Figure 4. Appropriate guidance at all accounting levels is essential to a reliable internal control structure and for the compilation of accurate data and presentation of reliable and timely financial statements. These problems occurred because DBOF accounting guidance was not always properly

Defense Business Operations Fund Financial Accounting

distributed or understood, up-to-date, or even developed in some cases. The adequacy and availability of accounting guidance were frequently cited as causing the deficiencies noted. Figure 4 divides the guidance problem into several subcategories, further pinpointing specific weaknesses. Figure 4 shows auditor-recommended adjustments of \$760.6 million associated with poor distribution of guidance, \$4.7 billion with lack of compliance, and \$7.8 billion with insufficient or inapplicable guidance.

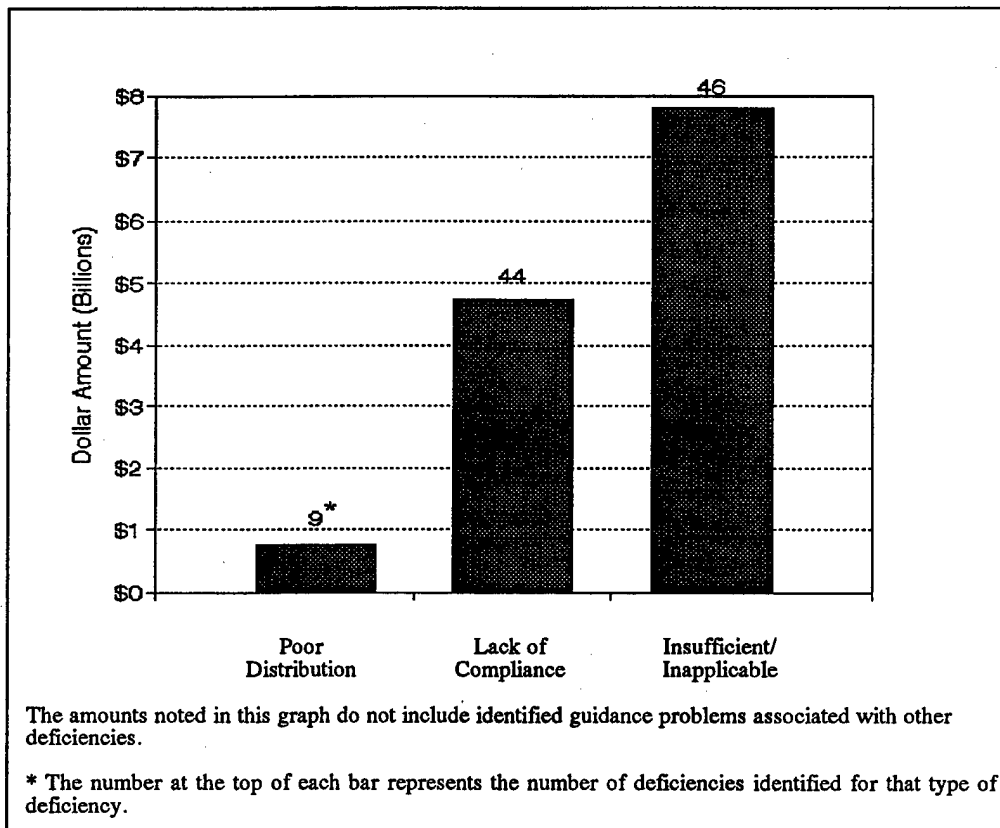


Figure 4. Problems With Guidance

Although DoD has partially addressed this problem by issuing the Financial Management Regulation, Volume 11B, in December 1994, recent audits and followup reviews reveal continued weaknesses in guidance. For example, many Navy activities generally relied on the Navy Comptroller Manual, although new DoD guidance was available and took precedence. Moreover, much of the revised policy replacing the Navy DBOF guidance had not been received by activities required to implement it. In some cases, Navy financial managers were not aware that new DoD guidance had been issued. Some managers who had not received guidance were forced to independently decide what procedures to follow when processing transactions and preparing financial statements.

Significant inventory valuation problems were also caused by deficient procedures. The DFAS Indianapolis Center did not correctly revalue Stockpile Materiel and Inventory, Net, because guidance from DFAS Headquarters did not recognize differences in the various segments of inventory and the corresponding need to revalue the segments separately. As a result, the Inventory, Net, line in the FY 1994 Army financial statements was overstated by about \$411 million, and the Stockpile materiel line was understated by about \$483 million.

Another \$523 million in auditor-recommended adjustments regarding accounting and inventory problems at Air Force DBOF activities was caused by a lack of adequate guidance or failure to follow revised guidance. Managers and accountants at DFAS centers and field finance offices repeatedly referred to an absence of DBOF accounting guidance, some indicating that they did not know who to contact when they had questions.

Deficiencies in accounting guidance occurred principally because the procedures for distribution were faulty, implementation was irregular, and the guidance was insufficient or had not been developed. The relative newness and complexity of the DBOF, as well as pressures caused by DoD downsizing and reorganization, have significantly increased the difficulty of revising and distributing timely and pertinent guidance. Moreover, the cultural legacy of adherence to Service guidance by DFAS centers and field finance offices still plagues the DFAS. DoD included improved policies and procedures as a key component in its 1993 DBOF Improvement Plan. In the February 1, 1995, "DBOF Improvement Plan Progress Report," DoD stated that 22 of 26 planned corrective actions had been completed. Nevertheless, audits point to a continuing lack of adequate DBOF accounting guidance, which contributed to the inability to produce fairly presented financial statements. Thus, despite the issuance of the Financial Management Regulation, Volume 11B, and the DBOF Improvement Plan, many of the problems discussed will remain uncorrected if the guidance does not exist or is not universally distributed and implemented.

Property, Plant, and Equipment. Inadequate accounting for many items of PP&E materially distorted the preparation and presentation of the FY 1994 DBOF financial statements. Because of their high level of materiality on the financial statements, disregarded or improperly valued PP&E assets distorted the financial statements. This occurred because assets were improperly capitalized, incorrectly recorded, or lacked cost documentation. In some cases, asset depreciation was inaccurately calculated due to the inability to correctly estimate the age of assets or apply accurate methods of depreciation. In other instances, fixed assets had been received or removed without accounting recognition.

Poor or nonexistent guidance also contributed to many problems with fixed assets and asset depreciation. Additionally, the lack of documentation for older assets causes problems in accounting for PP&E assets. In many cases, there is no way to determine historical cost, other than by estimation, as suggested in the exposure draft on PP&E issued on February 28, 1995, by the Federal Accounting Standards Advisory Board. Deficiencies affecting PP&E totaled approximately \$347.9 million and were associated with seven auditor-

Defense Business Operations Fund Financial Accounting

recommended adjustments, as shown in Figure 1. The total amount of adjustments associated with PP&E accounting problems was not available because of DoD's inability to determine overall fixed asset balances or assign proper values to PP&E; therefore, the amount noted in the table is significantly understated.

DoD has responded to property accountability weaknesses by choosing to migrate to a DoD-wide standard property accountability system, designated as the Defense Property Accountability System. This system, scheduled for implementation throughout DoD by 1997, was developed to maintain property accountability and depreciation accounts, and to schedule preventive maintenance and monitor equipment utilization. Some DoD activities, such as DLA, plan to establish procedures to accurately report PP&E and related depreciation expenses by the end of FY 1995.

Valuation and Classification of Inventory and Other Accounts. Preparation of financial statements was flawed, and financial statements were not usable, as a result of inaccurate valuation in DoD inventory accounts and misclassification in other line item accounts. Significant inventory valuation and account classification problems existed in many DBOF business areas. These problems resulted in auditor-recommended adjustments of \$9 billion associated with 15 valuation and classification deficiencies (see Figure 5). The problems were caused by incorrect physical inventory counts, errors in transaction processing and recordkeeping, retention and incorrect reporting of excess inventories, inappropriate use of the Material-in-Transit account, faulty inventory guidance, incorrect implementation of guidance, and improper inventory revaluation.

Extensive inventory problems were noted throughout the DBOF. Auditors were unable to substantiate \$35.9 billion³ in Air Force inventory balances because stockpiled materials, items in repair, and items-in-transit were not supported by detailed subsidiary records. Moreover, an Air Force Inventory-in-Transit account valued at negative \$7.5 billion contributed to the IG, DoD, disclaimer on the FY 1994 DBOF Consolidated Statement of Financial Position. A negative account balance is illogical and clearly should not have appeared on the financial statements. Audits also revealed relatively minor inaccuracies in the Navy DBOF Supply System's inventory balances and records. Auditors reported that although DLA Supply Management had significantly improved the valuation, reporting, and disclosure of inventories, further improvements were needed in the internal control structure for transaction processing and followup procedures for inventory.

Inventories compose approximately 75 percent of total DBOF assets. Because of the high proportion of inventory to overall DBOF assets, continued material weaknesses in inventory will continue to impact the fair presentation of DBOF financial statements. Inventory problems will also make the goals of accurate cost recognition and cost planning more difficult to achieve. Again, we

³This amount was not included in the total of deficiency amounts for FY 1994.

Defense Business Operations Fund Financial Accounting

concluded that many problems with the internal control structure can be corrected by revising policies and procedures; such revisions should not await implementation of interim migratory systems.

Audits also have recognized accounting weaknesses in the area of account misclassification. Misclassification occurs when an account is debited or credited incorrectly, usually as a result of inadvertent errors, poor internal controls, or inadequate training. This results in an over- or understatement of the accounts affected. For example, at the DFAS Indianapolis Center, \$195 million of assets had been incorrectly transferred from Inventory for Agency Use to Other Assets. This misclassification was adjusted before the Army's financial statements were issued. Also, Defense Accounting Office personnel at the Ogden, Oklahoma City, and Warner Robins Air Logistics Centers did not properly classify and describe Depot Maintenance Service Equity Accounts, totaling \$932 million, in their financial reports. Significant account classification problems occurred in many DBOF accounts. Figure 5 shows the auditor-recommended adjustments for classification problems; it includes the DFAS Indianapolis Center's corrected deficiencies.

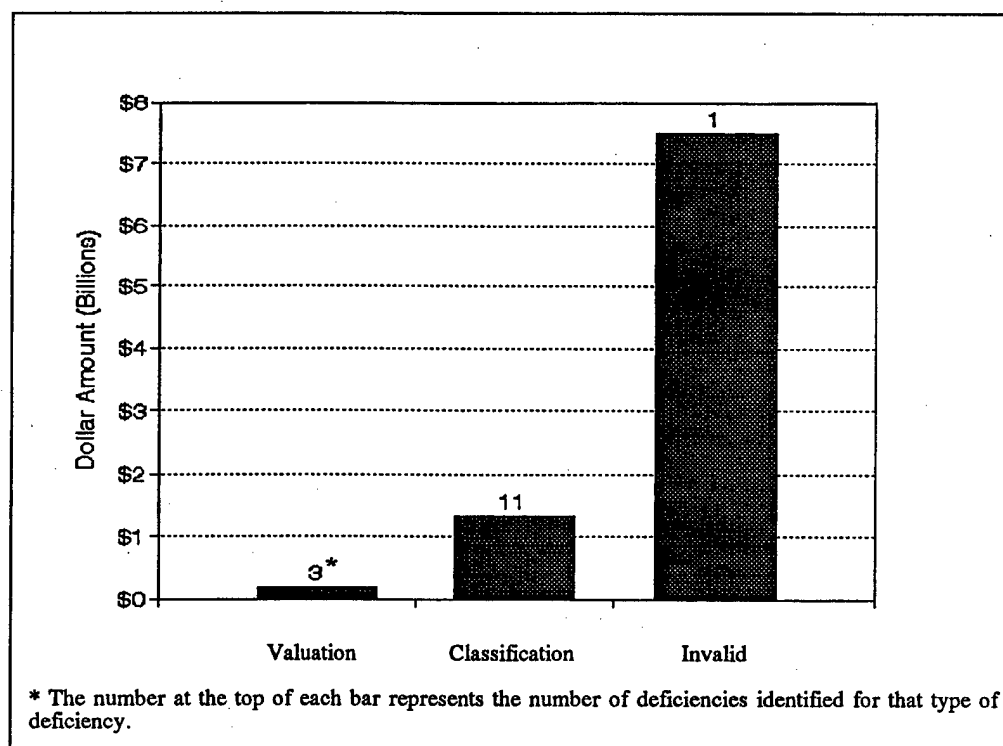


Figure 5. Deficiencies in Account Valuation and Classification

Personnel. Development and utilization of financial statements have been adversely affected by problems with accounting personnel. The effectiveness of personnel who process transactions and compile data has been diminished by inadequate training, shortages of support personnel, poor communication between field offices and headquarters, the loss of corporate knowledge caused

Defense Business Operations Fund Financial Accounting

by the retirement of experienced employees, and a lack of documented procedures. The loss of experienced personnel due to downsizing has contributed to this problem because operating procedures and instructions have not been documented. In our view, it is critical for a process to be documented before it can be improved or taught to staff. The DFAS reorganization is a positive initiative, but will continue to result in transition problems unless the internal controls are documented.

Conclusion

This summary of accounting deficiencies in the DBOF is the result of a review of various DBOF audits conducted during FY 1994. We identified several prominent categories of accounting deficiencies, totaling over \$53.6 billion. Large accounting deficiencies included policies and procedures at \$13.3 billion, documentation and audit trails at \$15.8 billion, intrafund transactions at \$5 billion, and inventory valuation and asset classification at \$9 billion. These deficiencies prevented the accurate compilation of accounting data and the development and presentation of complete, accurate, reliable, and timely financial statements. However, by implementing the DBOF Improvement Plan, DoD management has made some progress in correcting its accounting and financial systems. Moreover, DoD financial managers have acknowledged the seriousness of the problems within the DoD and DBOF accounting and financial systems, and have committed themselves to finding and applying remedies. In this report, we concentrated on identifying specific accounting deficiencies to suggest that management focus its scarce resources on weaknesses where corrections may have the highest immediate rewards. Management should:

- o implement the DoD Standard General Ledger in all interim migratory, migratory, and new accounting systems;
- o improve documentation and audit trails;
- o implement reasonableness and analytical edit checks for internal control;
- o develop and provide accounting guidance, ensure distribution to all users, and follow up to ensure consistent implementation;
- o improve accounting for PP&E;
- o improve accounting for valuation and classification of accounts; and
- o develop and improve documentation on critical accounting processes to assist personnel in preparing financial information.

Also, we believe that by focusing on the control environment and procedures as part of the internal control structure, management can address many of the problems identified, and should not await implementation of major

Defense Business Operations Fund Financial Accounting

improvements in accounting systems to do so. We plan to report annually on accounting deficiencies that significantly impair the compilation of DoD accounting data and prevent the production of useful and accurate financial statements.

Management Comments

The Under Secretary of Defense (Comptroller) provided comments on the draft report. He concurred with the report, stating that on balance, it fairly presented conditions that existed within the Defense Business Operations Fund during the period of the audit.

This page was left out of original document

Part II - Additional Information

Appendix A. Scope and Methodology

Statements Reviewed. We reviewed FY 1993 and 1994 financial statement audit reports on DBOF from the IG, DoD; the Army Audit Agency; the Naval Audit Service; and the Air Force Audit Agency. We also reviewed GAO audit reports regarding the DBOF and the DBOF Improvement Plan. Appendix B lists the reports reviewed. The amounts noted for each deficiency were taken only from FY 1994 audit reports. This audit was limited to identifying and summarizing the major accounting deficiencies that prevented the accurate development and reliable presentation of the DBOF financial statements. We defined a major deficiency as a problem that would materially distort or render unusable the DBOF financial statements. However, to note the prevalence of system-wide accounting problems, Appendix F shows both large and small deficiencies as reported in audit reports. A deficiency, as defined in this report, could consist of a large number of accounting errors at the transaction level. We also contacted DoD officials who were responsible for ensuring that corrective actions were taken or under way to remedy such accounting deficiencies.

Audit Period, Standards, Locations, and the Internal Management Control Program. We performed this program audit from December 1994 through April 1995. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the IG, DoD. We did not review the overall internal management control program because it was not relevant to the audit. Issues pertaining to internal controls in this report were taken from the audit reports we reviewed. We did not use computer-processed data or statistical sampling procedures to conduct this audit. Appendix I lists the organizations we visited or contacted.

Compliance With Laws and Regulations. We noted issues pertaining to compliance with laws and regulations only to the extent that such deficiencies were already included in the audit reports we reviewed. We also reviewed management's most recent Annual Statement of Assurance and supplemental financial and management information as part of our evaluation of the DBOF accounting systems.

Appendix B. Prior Audits and Other Reviews

General Accounting Office

GAO Report No. AIMD 95-79 (OSD Case No. 9859), "Defense Business Operations Fund Management Issues Challenge Fund Implementation," March 1, 1995. This report challenged the DoD assessment that implementation of the DBOF Improvement Plan had made "tremendous progress in rectifying or reducing many of the problems [identified] in the Plan." While acknowledging that DoD had made some progress from September 1993 through February 1995 by implementing the DBOF Improvement Plan, GAO stated that very little had changed in the day-to-day operations of the DBOF. GAO pointed to the following DBOF areas with continuing problems.

- o DoD lacked a system-wide process to ensure consistent implementation of DBOF policies.

- o DoD had selected most DBOF interim migratory systems without first estimating the costs of enhancing and implementing the systems.

- o DoD continues to have difficulty preparing accurate financial reports on DBOF operations.

- o DoD has reversed its cash management policy by returning cash control to the DoD Components. GAO stated that this was a major departure from the benefits of a single cash balance that DoD cited when the DBOF was established.

The report recommended that Congress require that DBOF prices recover the full costs of using military personnel. It also recommended a prohibition on using DBOF prices to recover prior-year losses. GAO further recommended that the USD(C):

- o ensure that an economic analysis is prepared for each of the recommended interim migratory systems before any money is spent on it,

- o reverse the decision to transfer management of DBOF cash to the Services and DoD Components, and

- o develop a system-wide process to ensure the uniform implementation of DBOF policies.

Inspector General, DoD

IG, DoD, Report No. 94-161, "Consolidated Statement of Financial Position of the Defense Business Operations Fund for FY 1993," June 30, 1994. The IG, DoD, was unable to render an opinion on the DBOF FY 1993 Consolidated Statement of Financial Position because significant internal control deficiencies existed, and significant instances of noncompliance with regulations were found. The IG, DoD, reported many internal control problems in four accounts of the DBOF financial statements. In the DBOF Fund Balance With Treasury account, the DoD definition of this account was not consistent with accounting principles, which made the balance misleading. Also, individual activities could not reconcile their own portions of the account because the information was integrated with other Fund Balance With Treasury information. Misstatements were reported for the DLA and the Navy for this account. The Inventory Held for Sale, Net, account and the Inventory Not Held for Sale account also had many problems. In addition to valuation and classification problems, material discrepancies were found for these accounts within many activities. For the Inventory Not Held for Sale account, negative inventory balances were reported, and the accuracy of the War Reserve Assets could not be verified. Finally, the Army and the Air Force did not keep appropriate source documentation for items included in the PP&E account, which made those portions of the account unauditable. Also, the Air Force did not report all PP&E in the DBOF financial statements. Additionally, the PP&E account for the Joint Logistics Systems Center was misstated because that activity had not implemented an effective internal control program.

The IG, DoD, reported many instances of noncompliance with regulations. The DFAS Indianapolis Center did not use an integrated general ledger to produce the FY 1993 financial statements, as required by OMB guidance, and several Army DBOF supply systems did not use the standard general ledger system required by DoD Manual 7220.9-M, "Department of Defense Accounting Manual," October 1983. The IG, DoD, also reported that the DLA had not effectively implemented an internal management control program over the reporting of results for physical inventories. Also, the Army valued all inventory at standard price, while the DLA valued reutilization and marketing inventories at standard price. Neither of those valuation policies adheres to the Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities," March 30, 1993. The IG, DoD, also reported that most Army Depot Maintenance activities did not have accounting systems that allowed them to compute depreciation for individual buildings, as required by the DoD Accounting Manual. Finally, the Notes to the FY 1993 DBOF Financial Statements were not in accordance with the "DoD Guidance on Form and Content of Financial Statements for FY 1993 and FY 1994 Financial Activity," January 12, 1994. The financial statements included only 4 notes instead of the required 26 notes. No recommendations were made in this report; therefore, management comments were not required, and none were received.

Appendix B. Prior Audits and Other Reviews

IG, DoD, Report No. 93-134, "Principal and Combining Financial Statements of the Defense Business Operations Fund - FY 1992," June 30, 1993. The IG, DoD, was unable to render an opinion on the DBOF FY 1992 Principal and Combining Financial Statements because audit trails were inadequate, accounting systems were inadequate, significant internal control deficiencies existed, significant instances of noncompliance with regulations were found, and legal and management representation letters were not received. The IG, DoD, reported many material internal control weaknesses that affected the reliability of the DBOF financial statements for FY 1992. Transactions were not properly recorded and accounted for because controls over cash were inadequate, transactions by and for others were not recorded in a timely manner, intrafund transactions were not eliminated or reported, and certain accounts were not properly accounted for. The IG, DoD, was unable to ensure that assets were safeguarded from unauthorized use because supporting documentation was lacking; also, the capital asset and inventory accounts were not correctly valued, and we could not determine their existence. The execution of transactions was not in compliance with existing guidance. Reconciliations, uniform accounting systems, and a standard general ledger system were lacking, and the weekly flash cash reports were unreliable.

Several instances of noncompliance with laws and regulations materially affected the reliability of the DBOF financial statements for FY 1992. For FY 1992, the accounting systems for DBOF did not meet the requirements of the Budget and Accounting Procedures Act of 1950 and "Title 2, GAO Policy and Procedures Manual for Guidance of Federal Agencies." The DBOF was not in full compliance with OMB Bulletin No. 93-02, "Form and Content of Agency Financial Statements," which implemented the Chief Financial Officers Act of 1990, and quarterly and annual reports to the Department of the Treasury on Accounts and Loans Receivable Due from the Public were not accurately prepared. Air Force Supply Management did not properly follow requirements of the DoD Accounting Manual. Real properties were improperly shown as assets on the DBOF financial statements and did not comply with Real Property Ownership under 10 U.S.C. section 2682. Finally, the DFAS Columbus Center and the Defense Commissary Agency were not fully complying with the Prompt Payment Act. No recommendations were made in this report; therefore, management comments were not required. We received comments from the Acting Chief Financial Officer, DoD. Management generally agreed with the report, but took exception to reportable conditions on inadequate audit trails and reported instances of noncompliance with the Budget and Accounting Procedures Act, GAO Title 2, OMB Bulletin No. 93-02, and the National Defense Authorization Act. We did not agree with those management comments.

Appendix B. Prior Audits and Other Reviews

Related Prior Audit Reports

<u>Report No.</u>	<u>Title</u>	<u>Date</u>
General Accounting Office		
AIMD-94-80	Financial Management, Status of the Defense Business Operations Fund (DBOF) ¹ (OSD Case No. 9339-D)	March 9, 1994
Inspector General, Department of Defense		
95-072	Defense Finance and Accounting Service Work on the FY 1993 Air Force DBOF Financial Statements	January 11, 1995
95-067	Defense Finance and Accounting Service Work on the Air Force FY 1993 Financial Statements	December 30, 1994
95-066	Application Controls - Navy Inventories	December 30, 1994
95-034	Development of Property, Plant, and Equipment Systems	November 21, 1994
95-023	Application Controls Over Selected Portions of the Standard Army Intermediate Level Supply System	November 4, 1994
94-199	Research on Accounting and Financial Reporting at the Defense Information Services Organization	September 30, 1994
94-183	Controls Over Commissary Revenues	September 6, 1994
94-168	Defense Finance and Accounting Service Work on the Army FY 1993 Financial Statements	July 6, 1994
94-167	Selected Financial Accounts on the Defense Logistics Agency DBOF Financial Statements for FY 1993	June 30, 1994

¹Acronym used in report titles for brevity.

Appendix B. Prior Audits and Other Reviews

<u>Report No.</u>	<u>Title</u>	<u>Date</u>
94-163	Management Data Used to Manage the U.S. Transportation Command and the Military Department Transportation Organizations	June 30, 1994
94-161	Consolidated Statement of Financial Position of the DBOF for FY 1993	June 30, 1994
94-159	Fund Balances With the Treasury Accounts on the FY 1993 Financial Statements of the Defense Logistics Agency Business Areas of the DBOF	June 30, 1994
94-150	Inventory Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the DBOF for FY 1993	June 28, 1994
94-149	Property, Plant, and Equipment Accounts on the Financial Statements of the Defense Logistics Agency Business Areas of the DBOF for FY 1993	June 28, 1994
94-147	Joint Logistics System Center's Financial Statements for FY 1993	June 24, 1994
94-128	Management Data Used to Manage the Defense Logistics Agency Supply Management Division of the DBOF	June 14, 1994
94-082	Financial Management of the DBOF - FY 1992	April 11, 1994
93-164	Financial Statements of DLA Supply Management Division of the DBOF (Defense Fuel Supply Center Financial Data) for FY 1992	September 2, 1993
93-153	DBOF Communication Information Services Activity Financial Statements for FY 1992	August 6, 1993
93-151	Compliance With the Federal Managers' Financial Integrity Act at the Defense Commercial Communications Office	July 26, 1993
93-147	Defense Commissary Resale Stock Fund Financial Statements for FY 1992	June 30, 1993

Appendix B. Prior Audits and Other Reviews

Report No.	Title	Date
93-134	Principal and Combining Financial Statements of the DBOF for FY 1992	June 30, 1993
Army Audit Agency		
NR 94-471	Army DBOF FY 93 Financial Statements: Report of Management Issues	September 29, 1994
NR 94-470	Army DBOF FY 93 Financial Statements: Audit Opinion	June 30, 1994
NR 94-457	DBOF, FY 92 Financial Statements: Common Management Issues	March 30, 1994
NR 94-456	DBOF, Transportation, Army FY 92 Financial Statements: Report of Management Issues	March 30, 1994
NR 94-454	DBOF, Depot Maintenance, Army FY 92 Financial Statements: Report of Management Issues	March 30, 1994
NR 93-463	DBOF Depot Maintenance, Army FY 92 Financial Statements: Audit Opinion	June 30, 1993
NR 93-462	DBOF Transportation, Army FY 92 Financial Statements: Audit Opinion	June 30, 1993
Naval Audit Service		
053-H-94	Fiscal Year 1993 Consolidating Financial Statements of the Department of the Navy DBOF	June 29, 1994
053-H-93	Fiscal Year 1992, Consolidating Financial Statements of the Department of the Navy DBOF	June 30, 1993

Appendix B. Prior Audits and Other Reviews

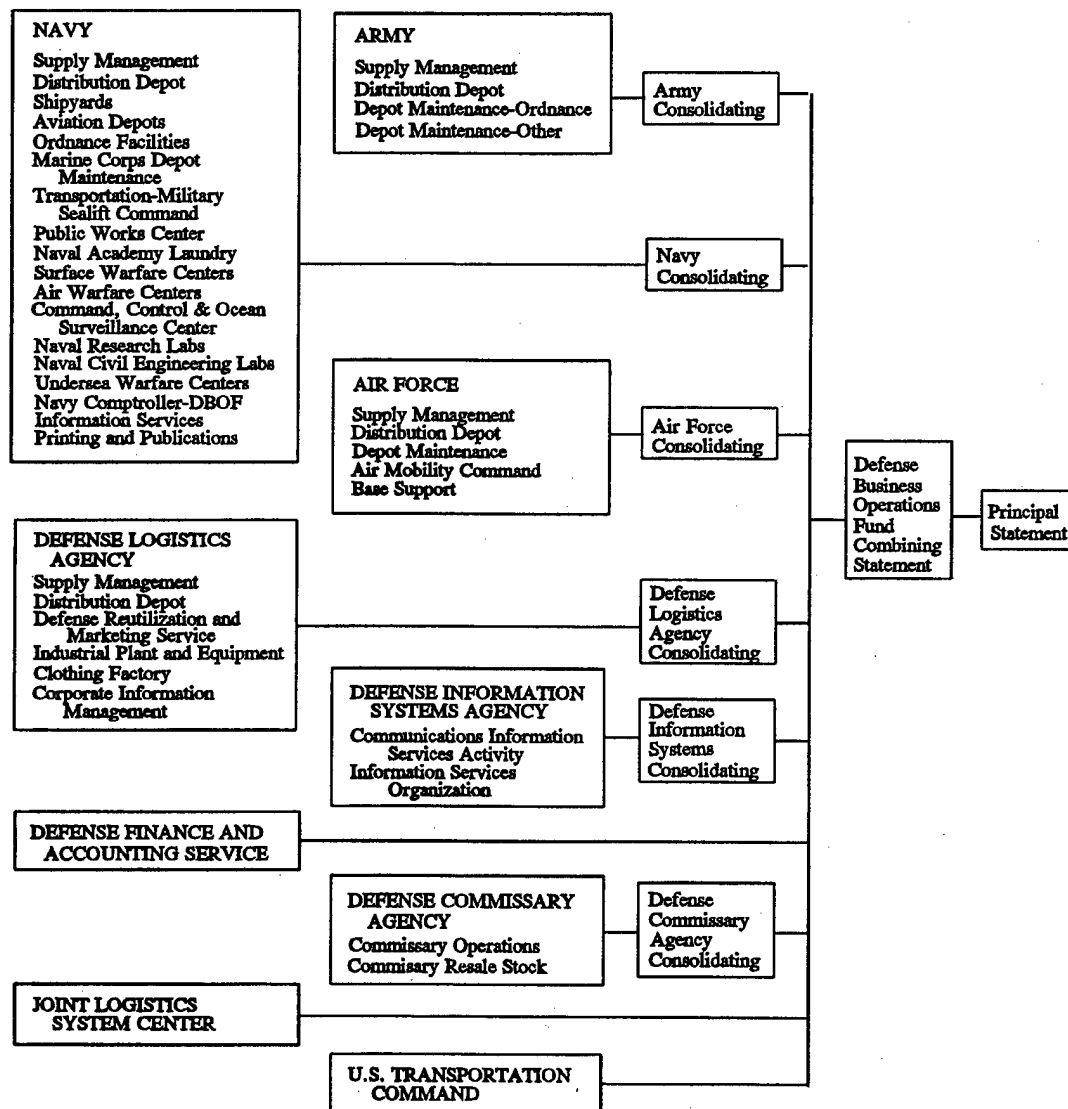
<u>Report No.</u>	<u>Title</u>	<u>Date</u>
Air Force Audit Agency		
94068020	Opinion on Air Force DBOF, Fiscal Year 1993 Fund Balance With Treasury	June 30, 1994
94068019	Opinion on Air Force DBOF, Fiscal Year 1993 Property, Plant, and Equipment Balances	June 30, 1994
94068018	Opinion on Air Force DBOF, Fiscal Year 1993 Inventories Not Held for Sale Balances	June 30, 1994
94068017	Opinion on Air Force DBOF, Fiscal Year 1993 Inventories Held for Sale Balance	June 30, 1994
94068025	Air Force Depot Maintenance Service, Fiscal Year 1993 Material In-Transit Balances	April 1, 1994
93068005	Internal Controls and Management Issues Related to Laundry and Dry Cleaning Service, DBOF, Fiscal Year 1992 Financial Statements	September 7, 1993
92066008	Review of the Design and Development Activities for the Depot Maintenance Management Information System	August 18, 1993
93068024	Opinion on Air Force Consolidating Statements, DBOF, Fiscal Year 1992 Financial Statements	June 30, 1993
93068012	Opinion on Air Force Distribution Depot, DBOF, Fiscal Year 1992 Financial Statements	June 30, 1993
93068011	Opinion on Air Force Supply Management, DBOF, Fiscal Year 1992 Financial Statements	June 30, 1993
92068003	Opinion on Laundry and Dry Cleaning Service, DBOF, Fiscal Year 1992 Financial Statements	June 30, 1993

Appendix B. Prior Audits and Other Reviews

<u>Report No.</u>	<u>Title</u>	<u>Date</u>
92068002	Opinion on Air Force Depot Maintenance Service, DBOF, Fiscal Year 1992 Financial Statements	June 30, 1993
92071002	Opinion on Air Force Transportation, DBOF, Fiscal Year 1992 Financial Statements	June 29, 1993
92066010	Review of General and Application Controls Within the Contract Depot Maintenance Production and Cost System	April 1, 1993
92066002	Review of General and Application Controls Within the Equipment Inventory, Multiple Status and Utilization Reporting Subsystem	April 1, 1993
92062001	Review of DMIF ² Revenue Accounts, Fiscal Year 1992 Financial Statements	February 28, 1993

²Depot Maintenance Industrial Fund.

Appendix C. Financial Statement Reporting Structure for the Defense Business Operations Fund



Appendix D. Summary of Work Performed by Others

Component	Business Area	FY 1994 Reported Assets	FY 1994 Expenses	Scope of Audit Work Performed	Organizations Performing Audit Work	Audit Report Number
Army	Supply Management	\$14,975,924,957	\$12,584,846,437	Limited ¹	Army Audit Agency	NR95-430
	Depot Maintenance-Other	1,091,090,500	2,056,475,503	Limited ¹	Army Audit Agency	NR95-430
	Depot Maintenance-Ordnance	706,105,248	594,046,384	None	Army Audit Agency	Unaudited
	Consolidating	16,773,120,705	13,180,880,462 ²	Limited ¹	Army Audit Agency	NR95-430
Navy	Supply Management	18,123,446,838	8,323,057,157	Limited ¹	Naval Audit Service	044-95
	Distribution Depot	(135,938,702)	164,498,811	None	Naval Audit Service	Unaudited
	Depot Maintenance-Shipyards	1,796,674,104	3,749,156,310	Limited ¹	Naval Audit Service	044-95
	Depot Maintenance-Aviation	919,627,855	1,961,426,381	Limited ¹	Naval Audit Service	044-95
	Depot Maintenance-Ordnance	404,082,819	669,695,988	Limited ¹	Naval Audit Service	044-95
	Depot Maintenance-Other Marine Corps	(16,703,056)	181,062,050	None	IG, DoD ³	Unaudited
	Transportation-Military Sealift Command	132,490,257	720,645,068	Limited ¹	IG, DoD ³	4FH-2011
	Base Support (includes Laundry Service)	989,276,307	1,920,158,628	Limited ¹	Naval Audit Service	044-95
	Logistics Support Activity	(8,959,609)	331,579,194	None	Naval Audit Service	Unaudited
	Naval Research Laboratories	143,266,607	502,796,098	Limited ¹	Naval Audit Service	044-95
	Naval Underseas Warfare Centers	342,800,307	993,057,693	Limited ¹	Naval Audit Service	044-95
	Naval Air Warfare Centers	422,059,395	2,684,581,970	Limited ¹	Naval Audit Service	044-95
	Naval Surface Warfare Centers	491,573,179	2,541,571,452	Limited ¹	Naval Audit Service	044-95
	Naval Command, Control & Ocean Surveillance Center	210,173,257	961,495,606	Limited ¹	Naval Audit Service	044-95
	Naval Civil Engineering Laboratories	8,791,624	50,206,100	None	Naval Audit Service	Unaudited
	Information Services	102,147,160	367,097,718	None	Naval Audit Service	Unaudited
	Printing and Publications	120,647,011	412,966,674	Limited ¹	Naval Audit Service	044-95
	Consolidating	25,063,883,444 ²	26,534,773,752 ²	Limited ¹	Naval Audit Service	044-95
Air Force	Supply Management	34,216,473,284	9,945,975,954	Limited ¹	Air Force Audit Agency	94068041
	Base Support	8,640,810	7,129,207	None	Air Force Audit Agency	Unaudited
	Transportation-Air Mobility Command	734,892,676	2,782,341,003	Limited ¹	Air Force Audit Agency/IG, DoD ³	94068040
	Depot Maintenance	1,399,219,672	4,221,789,210	Limited ¹	Air Force Audit Agency	94068039
	Consolidating	36,182,650,442 ²	13,211,350,219 ²	None	Air Force Audit Agency	Unaudited

- ¹The audit was limited to a review of the Statement of Financial Position.
²Consolidating amounts do not agree with the business area amounts due to intrafund elimination transactions.
³Included in IG, DoD, consolidated TRANSCOM audit (Project No. 4FH-2011).
⁴The audit was limited to a review of selected accounts.
⁵The audit was limited to a review of the Statement of Financial Position and the Statement of Operations.

Appendix D. Summary of Work Performed by Others

Component	Business Area	FY 1994 Reported Assets	FY 1994 Reported Expenses	Scope of Audit Work Performed	Organization Performing Audit Work	Audit Report Number
Defense Logistics Agency	Supply Management Distribution Depots Reutilization and Marketing Service Industrial Plant and Equipment Center Clothing Factory Consolidating	12,164,108,079 943,921,378 576,866,260 177,538,370 7,077,127 13,869,511,214	12,794,833,361 1,597,964,120 367,289,330 23,795,246 26,640,839 14,810,522,896	Limited ⁴ Limited ⁴ Limited ⁴ None None None	IG, DoD IG, DoD IG, DoD IG, DoD None None	95-195 95-197 95-220 Unaudited Unaudited Unaudited
Defense Information Systems Agency	Communications Information Services Activity Defense Information Service Organization	495,144,000 335,866,418	1,503,327,000 592,802,015	Limited ⁵ Limited ⁴	IG, DoD IG, DoD	95-219 95-209
Defense Finance and Accounting Service	DFAS Operations	384,551,513	1,692,482,390	None	Unaudited	Unaudited
Defense Commissary Agency	Commissary Operations Resale Stocks Consolidating	(1,164,193,000) 756,003,000 (408,190,000)	1,087,244,000 5,579,301,000 6,666,545,000	Limited ⁵ Limited ¹ None	IG, DoD IG, DoD	95-217 95-228 Unaudited
Joint Logistics Service Center	Consolidating	198,030,897	29,763,124	None	Unaudited	Unaudited
U.S. Transportation Command	Consolidating	3,180,445,653	5,678,275,073	Limited ¹	IG, DoD	4FH-2011
Corporate Account	Consolidating	7,869,663	287,303	None	Unaudited	Unaudited
Departmental	Consolidating	6,547,882,814	729,928,705	None	Unaudited	Unaudited
Total		\$102,622,403,632 ²	\$83,249,629,874 ²			

- ¹The audit was limited to a review of the Statement of Financial Position.
²Consolidating amounts do not agree with the business area amounts due to intrafund elimination transactions.
³Included in IG, DoD, consolidated TRANSCOM audit (Project No. 4FH-2011).
⁴The audit was limited to a review of selected accounts.
⁵The audit was limited to a review of the Statement of Financial Position and the Statement of Operations.

Appendix E. Account Deficiencies Identified

<u>Account</u>	<u>Accounting Systems'¹ Characteristics¹</u>	<u>Guidance²</u>	<u>Valuation/ Classification³</u>
Fund Balance With Treasury	X	X	X
Accounts Receivable	X	X	X
Advances and Prepayments	X	X	
Cash and Other Monetary Assets	X	X	
Inventory, Net	X	X	X
Operating Materials/Supplies, Net		X	X
Stockpile Materials, Net		X	X
Property, Plant, and Equipment	X	X	X
Accounts Payable	X	X	X
Accrued Payroll and Benefits		X	
Other Federal Liabilities	X	X	X
Net Position		X	X
Revenues	X	X	X
Expenses	X	X	X
Footnotes		X	

¹Includes: Standard General Ledger, Documentation/Audit Trail, Intrafund Transactions, Footnotes, Reasonableness and Analytical Edit Checks, and System Inadequacy.

²Includes: Distribution, Compliance, and Insufficient or Inapplicable Guidance.

³Includes: Classification, Valuation, and Invalid Account/Transaction.

Appendix F. Status of Deficiencies

Status of Deficiencies Identified by Inspector General, DoD

<u>Source</u>	<u>Description</u>	<u>Amount</u>	<u>Corrected</u>
IG, DoD, Report No. 95-195			
Finding A. Accounts Receivable	Accounts Receivable was overstated due to differences in processing time between the general ledger and the Treasury financial network.	\$ 91,400,000	No
	Collections were received but not posted to the accountable records.	9,500,000	No
	Customers were not billed for services because funding documents were not received.	33,300,000	No
	Accounts Receivable (including undistributed collections) were not researched, validated, or followed up regarding overaged accounts receivable and unmatched collection documents that have existed since FY 1991.	511,200,000	No
	Accounts Receivable was invalid due to other problems.	6,500,000	No
Finding B. Accounts Payable	Accounts Payable was overstated due to differences in processing time between the general ledger and the Treasury financial network.	110,400,000	No
	Payables were disbursed but not posted to accounting records.	8,780,000	No
	Overaged and negative accounts payable records and unmatched disbursement documents were not resolved because of: <ul style="list-style-type: none"> o a lack of research, o a lack of validation, and o a lack of followup on overaged accounts receivable. 	524,610,000	No
Finding C. Followup on Prior Audit Issues	Inventory was overaged and included negative balances.	154,500,000	No

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
IG, DoD, Report No. 95-197	Accounts Receivable was unsupported and unverifiable because the general ledger was adjusted to match Treasury records.	\$303,900,000	No
	Accounts Payable was unsupported and unverifiable because the general ledger was adjusted to match Treasury records.	97,400,000	No
	Accounts Payable was overaged and could not be verified or validated due to a lack of supporting documentation.	75,700,000	No
	Accounts Receivable included negative amounts.	19,900,000	No
IG, DoD, Report No. 95-220 Finding A. Verification of Account Balances	Accounts Receivable could not be verified because guidance directed the use of Treasury finance network data instead of related accounting record data.	40,187,539	No
	Accounts Payable could not be verified because guidance directed the use of Treasury finance network data instead of related accounting record data.	34,828,045	No
	Cash had been erroneously deposited into a suspense account (transferred to the correct account as a result of the audit).	1,700,000	Yes
	Accounts Payable was understated because Accounts Payable for hazardous disposal contracts was not established.	80,800,000	No
	Accounts Receivable processed in the Europe Region included amounts that had not been billed, due to a lack of validity review.	4,300,000	No
	Accounts Payable processed in the Europe Region included amounts that had been paid, due to a lack of validity review.	5,300,000	No
	Cash deposits certified as being completed (transferred out of the suspense account) were still in a suspense account.	478,000	Yes
	Sales were held in a suspense account at the Defense Reutilization and Marketing Service's Columbus, OH, office.	995,000	Yes
	Sales were held in a suspense account at the Defense Reutilization and Marketing Service's Mechanicsburg, PA, office.	214,262	Yes

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
Finding B. Statement of Operations	FY 1992 collections were not recorded in the accounting system until FY 1994 due to inadequate internal controls.	\$ 19,600,000	Yes
	Adjustments used to convert from cash to accrual accounting were not supported by subsidiary records.	25,800,000	No
	Adjustments to Accounts Receivable were inaccurate.	12,000,000	No
	Adjustments to Accounts Payable were inaccurate.	9,500,000	No
	Transfers to remove pre-FY 1994 sales revenue from the accounting system could not be validated.	11,600,000	No
	Transfers to remove pre-FY 1994 sales revenue from the accounting system were understated.	2,000,000	No
	Expenses were understated because hazardous disposals were accounted for on a cash basis.	7,200,000	No
	Revenues were overstated because they were not matched to expenses necessary to produce them.	73,600,000	No
	Billing authority was unnecessarily retained, although the DoD position stated that projected DBOF proceeds from public sales will cover operating costs.	208,300,000	No
	The accuracy of the Expenses balance could not be determined because:	367,300,000	
IG, DoD, Report No. 95-217	o detailed subsidiary ledgers were not maintained for accrued expenses,		No
	o significant time lags existed between the posting of expenses and the disbursements to pay the expenses,		No
	o budget documents were used to record expenses, causing problems with matching obligations to expenses,		No
	o capital equipment accounts were understated, and		No
	o depreciation accounts were understated.		No
Finding A. Accounts Payable	Accounts Payable was overstated due to a lack of effective accounting controls and review processes.	33,800,000	Yes

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
	Accounts Payable included invalid negative amounts, due to a lack of effective accounting controls and review processes.	\$ 1,400,000	No
Finding B. Transportation of Things	Cost of Goods Sold, Intragovernmental, was not supported by adequate documentation.	121,700,000	No
Review of Compliance With Laws and Regulations	Assets included negative balances.	1,164,000,000	No
IG, DoD, Report No. 95-228			
Finding A. Inventory	Physical inventory losses occurred due to inadequate internal controls.	55,400,000	No
	Inventory in Transit was overstated due to mismatched transactions in the subsidiary files.	111,000,000	No
Finding B. Accounts Receivable	Accounts Receivable was inaccurate due to inadequate internal controls.	6,987,835	No
	Collections were applied to incorrect billing numbers.	12,100,000	No
	Accounts Receivable was overaged.	35,000,000	No
Finding C. Accounts Payable - Government	General ledger account balances were not reconciled to supporting documentation.	68,800,000	No
IG, DoD, Project No. 4FD-2015.01			
Finding A. Inventory Footnote Disclosure	A footnote on Excess, Obsolete, and Unserviceable Inventory was materially misstated due to inadequate guidance.	9,429,000,000	No

Status of Deficiencies Identified by Army Audit Agency

Army Audit Agency Report
No. NR 95-424 (Proposed
Adjustment Report)

Proposed adjustment number 2	Adjustment needed to correct clerical error in year-end reclassification.	\$195,046,701	Yes
------------------------------	---	---------------	-----

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
Proposed adjustment number 5	Inventory that depot maintenance activities returned for credit was misclassified as Operating Materials and Supplies instead of Other Entity Assets.	\$ 35,471,555	Yes ¹
Proposed adjustment number 7	Other Intragovernmental Liabilities for FY 1993 were overstated. August and September year-to-date amounts were added together, thereby overstating the account by the August year-to-date amount.	651,429,760	Yes
Proposed adjustment number 8	Transactions between the Army and Non-Army activities were omitted from the FY 1994 Army Business Operations Fund Financial Statement.	419,768,431	Yes
Completed adjustment numbers 1 through 3	Other Liabilities were overstated, due to the inclusion of invalid transactions that were more than 2 years old.	351,333,259	Yes ¹
Army Audit Agency Report No. NR 95-430			
Finding A. Revaluation and Classification of Inventory	Inventory, Net, was overstated by \$411 million and Stockpile Materials was understated by \$483 million because guidance for valuing inventory did not recognize differences in the various segments of inventory and the corresponding need to revalue the segments separately.	894,000,000	No
Finding B. Deferred Revenue, Depot Maintenance	Deferred Revenue from depot maintenance activities was understated due to an assumption that the amounts were based on estimates.	21,000,000	Yes

Status of Deficiencies Identified by Inspector General, DoD, and Provided to Army Audit Agency

IG, DoD, Report Submitted to the Army Audit Agency, February 6, 1995	Other Revenues and Financing Sources and Other Expenses were understated because the DFAS Indianapolis Center did not follow new procedures set up for voucher processing.	\$1,900,000,000	Yes
IG, DoD, Audit Assist Reviews Provided to the Army Audit Agency	Manual vouchers were not supported.	5,441,000,000	Yes
	Journal vouchers were not supported.	5,474,409,000	Yes

¹The adjustment was made to correct the FY 1994 statements; however, the underlying problem has not been corrected.

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
Status of Deficiencies Identified by Naval Audit Service			
Naval Audit Service Report No. 044-95			
Finding 1: Collection Estimates	Collections was overstated and the Invested Capital account was understated due to the use of estimates instead of actual data.	\$803,000,000	Yes
Finding 2: Accounts Receivable, Net, Federal	Accounts Receivable, Net, Federal, was misstated due to: <ul style="list-style-type: none"> o misclassified receivables, o unreported receivables, o invalid receivables on the books, and o sales estimates used to determine receivables. 	37,000,000	Partly (\$24.9 million)
Finding 3: Advances and Prepayments, Non-Federal	Advances and Prepayments, Non-Federal, was overstated due to: <ul style="list-style-type: none"> o deficiencies in contract review, o deficiencies in closeout procedures, and o improper registration of payment data. 	77,773,000	Yes
	Erroneous Liquidation Charge understated progress payments.	3,857,000	Yes
Finding 4: Accuracy of Inventory Records	Inventory was misstated due to inaccurate records.	34,800,000	No
Finding 5: Inventory Balances	Operating Materials/Supplies, Net, was misstated due to: <ul style="list-style-type: none"> o retention and inappropriate reporting of excess inventories, o inappropriate use of the Material-in-Transit account, and o erroneous inventory records. 	116,600,000	No
Finding 6: Property, Plant, and Equipment, Net	Property, Plant, and Equipment, Net, was misstated due to: <ul style="list-style-type: none"> o missing assets, o unsupported costs, o miscalculations in depreciation, o capital leases not capitalized, o assets received but not recorded, o construction projects not capitalized, and o assets recorded in an improper time period. 	190,400,000	No
	Cumulative Results of Operations were overstated because depreciation was not charged against operations.	15,500,000	No

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
Finding 7: Other Entity Assets	Assets classified as not-in-use were actually in use or were no longer owned by the reporting activity.	\$ 8,000,000	No
	Accumulated Depreciation was misclassified in the Property, Plant, and Equipment, Net, contra account instead of the Other Entity Assets contra account.	20,500,000	No
	Assets classified as not-in-use were overstated or unreported.	1,200,000	No
Finding 8: Accounts Payable, Federal	Accounts Payable, Federal, was misstated due to:	65,800,000	No
	<ul style="list-style-type: none"> o payment of recorded payables without sufficient supporting documents, o payment of recorded payables without adjusting accounts payable, o bookkeeping and input errors, o unrecorded price variances, o a lack of internal controls, and o improperly recording FY 1994 payables in FY 1995. 		
Finding 9: Other Federal (Intergovernmental) Liabilities	Other Federal Liabilities was overstated due to system-wide processing problems.	356,200,000	Yes
Finding 10: Accounts Payable, Non-Federal	Accounts Payable, Non-Federal, was misstated due to:	141,200,000	Partly (\$91.6 million)
	<ul style="list-style-type: none"> o untimely processing and posting, o inadequate records, o untimely follow-up, o confusion about responsibilities, o insufficient audit trails, o bookkeeping errors, o accounting system deficiencies, and o imprecise accounting period cutoffs. 		
Finding 11: Accrued Payroll and Benefits	Accrued Payroll and Benefits was misstated due to:	27,600,000	No
	<ul style="list-style-type: none"> o prorating problems, o confusion regarding guidance, and o insufficient management oversight. 		
Finding 12: Other Non-Federal (Governmental) Liabilities	Other Non-Federal (Governmental) Liabilities was overstated due to overaged accounts, negative amounts, and incorrect processing.	154,300,000	No
	Accounts Payable, Non-Federal, lacked documentation.	121,800,000	No
	Reimbursable order accruals were misclassified as Accounts Payable, Non-Federal.	52,900,000	No

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
Finding 13: Undistributed Collections and Disbursements	Undistributed collection and disbursement balances were posted to Accounts Payable, Federal and non-Federal, causing accounts to become negative, due to inadequate DoD guidance.	\$682,800,000	No
Finding 14: Intrafund Eliminations	Intrafund transaction amounts were not captured due to insufficient guidance.	4,600,000,000	No
Finding 15: Cash Levels	Fund Balance With Treasury was overstated due to untimely reporting of collections and the use of estimates.	800,000,000	No ²
Finding 16: Cash Reconciliation	Collections and disbursements reported on the Navy DBOF Consolidated Financial Statements could not be reconciled to individual activity records because different sources of information were used.	2,200,000,000	No
Finding 21: Reporting Non-Entity Assets	Navy DBOF activities had physical custody of sponsor-provided assets that were not reported on the Navy DBOF Consolidating Financial Statements due to unclear guidance.	1,600,000,000	No

Status of Deficiencies Identified by Air Force Audit Agency

Air Force Audit Agency
Project No. 94068038

Tab C: Summary of Installation-Level Findings	The Sales and Cost of Sales balances included unsupported adjustments and a posting error.	\$ 77,000,000	N/A ³
	Standard Base Supply System transactions did not properly interface with the Standard Materiel Accounting System because Defense Accounting Office personnel did not effectively monitor the interfaces.	120,817	N/A

Air Force Audit Agency
Project No. 94068039

Tab A: Accounts Receivable	Incremental revenue and unbillable losses were misclassified as Accounts Receivable due to inadequate guidance.	194,800,000	No
-------------------------------	---	-------------	----

²This overstatement existed as of February 28, 1995. On February 1, 1995, the Under Secretary of Defense (Comptroller) reassigned cash management responsibility from the DoD to the Service level. This deficiency was related to Finding 1 as both were caused by the use of the same incorrect estimates.

³Corrective status was not available (N/A) for this report.

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
	Accounts receivable lacked supporting documentation due to inadequate cutoff procedures.	\$207,900,000	No
Tab B: Floating Stock and Material in Stores	Assets and Accounts Payable were overstated due to increases in the value of Floating Stock being misclassified as Accounts Payable and Operational Overhead Expense.	360,000	No
	Physical inventory counts of Floating Stock and Material in Stores were not conducted on an annual basis due to inadequate guidance and noncompliance with guidance.	1,515,582	No
	Inventory errors.	1,770,956	No
Tab C: Property, Plant, and Equipment	Property, Plant, and Equipment were unrecorded because equipment custodians did not provide accounting personnel with the total value of uninstalled equipment.	16,100,000	Yes
	Supporting documentation did not exist for Property, Plant, and Equipment.	63,400,000	N/A
Tab D: Progress Billings and Unearned Revenue	Incremental revenue was misclassified as progress billings and unearned revenue.	298,996,579	No
Tab E: Accounts Payable	Changes in the value of floating stocks were improperly posted to Accounts Payable due to improper and insufficient guidance.	10,000,000	No
	Accounts Payable was not supported by documentation.	1,400,000	Yes
	Accounts Payable incorrectly included entries made to balance three other general ledger accounts, due to improper and insufficient guidance.	14,000,000	Yes
	Accrued liabilities were misclassified as Accounts Payable.	8,900,000	No
	Accounts Payable was not recorded due to insufficient guidance.	791,215	No
Tab F: Net Position	Equity accounts were not properly classified and described in the financial reports because guidance was not disseminated.	932,000,000	No
	Adequate footnote disclosures were not provided for net position account balances due to noncompliance with guidance.	372,000,000	No

Appendix F. Status of Deficiencies

Source	Description	Amount	Corrected
Air Force Audit Agency Project No. 94068040			
Tab A: Accounting Entries	Accounting transactions were inaccurate and unsupported due to insufficient personnel training and quality assurance programs.	\$1,400,000,000	No
	International Tariff Rate revenue was misclassified as unearned revenue.	11,900,000	No
	Liability accounts were not updated monthly due to noncompliance with guidance.	4,000,000	No
	Accrued Salaries and Wages were misclassified as Employer's Share of Fringe Benefits.	968,000	Yes
	The general ledger Accounts Payable-Government balance did not match the trial balance of Accounts Payable-Government.	1,600,000	No
	Accounts Payable were not accurately allocated between Government and Non-Government accounts.	65,400,000	No
	Disbursement vouchers were improperly posted because procedures were not implemented.	110,114	No
	Improper rates and data were used to estimate Contingency Billings and Accounts Receivable.	15,000,000	No
	Revenue collections were inaccurately estimated.	113,000,000	No
	Early payments were made to commercial airlines due to noncompliance with the Prompt Payment Act.	811,000	No
	Documentation was not available to support the cost of capitalized equipment.	131,000,000	No
	Adjustments to Accounts Payable were not supported by documentation.	36,250,000	N/A
	Accumulated Operating Results included an entry that could not be supported.	428,000	N/A
	Revenues and related Accounts Receivable were not adequately supported by documentation.	174,000,000	N/A

Appendix F. Status of Deficiencies

<u>Source</u>	<u>Description</u>	<u>Amount</u>	<u>Corrected</u>
Tab B: Net Position	A net treasury balance journal voucher was not supported by documentation.	\$275,000,000	Yes
	Transactions in Assets Capitalized and Liabilities Assumed were inaccurate due to inadequate guidance.	2,600,000	Yes
Tab C: Contingency Accounts Receivable	Contingency revenues were not recorded due to an incomplete list of mission identifiers provided by the customer.	2,800,000	Yes
	Customers were incorrectly billed for commercial contingency missions due to noncompliance with guidance.	1,200,000	No
Tab D: Real Property	Real property facilities were not recorded due to insufficient guidance.	155,497,906	No
	Depreciation expense was understated due to a failure to accurately estimate the age of the facilities.	2,000,000	No
Air Force Audit Agency Project No. 94068041			
Tab A: Accounts Payable	Accounts payable was not supported by subsidiary records due to an inadequate accounting system.	99,300,000	No
Tab B: Property, Plant, and Equipment	Capital equipment balances could not be validated due to a lack of supporting documentation.	13,100,000	N/A
Miscellaneous Problem	Air Force In-transit Inventory Account showed a negative balance.	7,500,000,000	Partly (\$3.6 billion)

Appendix G. Internal Control Structure*

An entity's internal control structure consists of policies and procedures to provide reasonable assurance that the organization's objectives will be achieved. In a financial statement audit, the auditors test the entity's ability to process, summarize, and report financial data consistent with auditing standards. The internal control structure is divided into three elements: the control environment, the accounting system, and the control procedures.

Control Environment. The control environment represents the entity's various influences that establish, enhance, or mitigate the effectiveness of specific policies and procedures. The entity's organizational structure, the function of the board of directors, methods of assigning authority and responsibility, management's control methods for monitoring and following up on performance, and personnel policies and practices are a few examples of influences on the control environment. The control environment reflects the overall attitude, awareness, and actions of the board of directors, management, owners, and others concerning the importance of control and its emphasis in the entity.

Accounting System. The accounting system consists of the methods and records that identify, assemble, analyze, classify, record, and report an entity's transactions and maintain accountability for the related assets and liabilities. Generally, an effective accounting system will ensure that an adequate audit trail exists to fully support a transaction.

Control Procedures. Control procedures are the policies and procedures used by management, in addition to the control environment and accounting system, to achieve the entity's objectives. The process of authorizing transactions and activities, segregation of duties, safeguards over assets, and independent checks on performance and proper valuation of recorded amounts are a few examples of control procedures.

A proper internal control structure lays the foundation for efficient and effective operations. By establishing the elements of a proper internal control structure, management enhances its ability to obtain information that is accurate and timely and is able to make informed decisions. With the firm commitment of management, a strong internal control structure can overcome existing accounting system deficiencies and permit the presentation of financial statements that are fairly stated.

*"Codification of Statements on Auditing Standards" §319.06 through §319.11.

Appendix H. Key Accounting Requirements*

- 1. General Ledger Control and Financial Reporting.** The system must have required general ledger control, in the structure approved by DoD, with appropriate reports provided for both management and external reporting purposes.
- 2. Property and Inventory Accounting.** The system must adequately account, both quantitatively and monetarily, for the procurement, receipt, issue, and control of plant property, equipment, inventory, and material.
- 3. Accounting for Receivables Including Advances.** The system must account for all accounts receivable accurately and promptly to provide reliable financial status reports.
- 4. Cost Accounting.** The system shall provide cost accounting, with accounting analysis and reporting on the costs of production of goods or services, or on the operation of programs, activities, functions, or organizational units, when required.
- 5. Accrual Accounting.** The system must recognize the accountable aspects of financial transactions or events as they occur, with accrual accounting that meets the specific needs of management and Congress.
- 6. Military and Civilian Payroll Procedures.** The accounting system providing obligation and accrual data will interface with the payroll system, with general ledger and payroll record reconciliations performed.
- 7. Systems Controls (Fund and Internal).** For fund control, the system must ensure that obligations and expenditures do not exceed the amounts appropriated, apportioned, reapportioned, allocated, and allotted. For internal control, the system must have adequate controls to prevent, detect, and correct errors and irregularities that may occur throughout a system.
- 8. Audit Trails.** The system must have audit trails that permit a transaction to be traced from initiation through processing to final reports.
- 9. Cash Procedures and Accounts Payable.** The system shall be designed to ensure timely payments based on properly approved disbursement transactions in compliance with the Prompt Payment Act and cash management principles. The system must record accounts payable liabilities when goods or services are received, with annual financial statements reflecting amounts due for goods and services received in the proper accounting period.

*Under Secretary of Defense (Comptroller) "Auditability Self-Assessment," January 24, 1995. These definitions are abridged versions of the key accounting requirements found in DoD Regulation 7000.14-R, "Financial Management Regulation," Volume 1, May 1993.

Appendix H. Key Accounting Requirements

10. System Documentation. The accounting system must have adequate documentation to document interfaces between system segments, functional users' accounting requirements, internal controls, system processes and data flow, and conformance with DoD requirements.

11. System Operations. The system must ensure that financial management and accounting objectives are met in an economical and efficient manner in the operation of the system, satisfying legal requirements, regulations, accounting principles and standards, and related requirements as prescribed.

12. User Information Needs. The system shall adequately satisfy user needs as to quality, accuracy, timeliness, reliability, and responsiveness of the system and its products.

13. Budgetary Accounting. The system shall support formulation of the budget, support budget requests, and control budget execution.

Appendix I. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller), Washington, DC
Director of Revolving Funds, Office of the Deputy Comptroller (Program/Budget),
Washington, DC
Director of Accounting Policy, Office of the Deputy Chief Financial Officer,
Washington, DC
Deputy Under Secretary of Defense (Logistics), Washington, DC

Department of the Army

Army Audit Agency, Alexandria, VA
Army Audit Agency, Letterkenny Army Depot, Chambersburg, PA

Department of the Navy

Naval Audit Service, Arlington, VA
Naval Audit Service, Southeast Region, Virginia Beach, VA
Naval Supply Systems Command, Arlington, VA

Department of the Air Force

Air Force Audit Agency, Wright-Patterson Air Force Base, OH

Other Defense Organizations

Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service Columbus Center, Columbus, OH
Defense Finance and Accounting Service Denver Center, Denver, CO
Defense Finance and Accounting Service Indianapolis Center, Indianapolis, IN
Defense Accounting Office, Arlington, VA
Defense Logistics Agency, Arlington, VA

Appendix J. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Health Affairs)
Assistant to the Secretary of Defense (Public Affairs)
Deputy Under Secretary of Defense (Logistics)
General Counsel of the Department of Defense

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, U.S. Army Corps of Engineers

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Unified Command

Commander in Chief, United States Transportation Command

Other Defense Organizations

Director, Advanced Research Projects Agency
Director, Ballistic Missile Defense Organization
Director, Central Imagery Office
Director, Defense Commissary Agency
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
 Director, Defense Finance and Accounting Service Cleveland Center
 Director, Defense Finance and Accounting Service Columbus Center
 Director, Defense Finance and Accounting Service Denver Center
 Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Information Systems Agency
Director, Defense Intelligence Agency
Director, Defense Investigative Service
Director, Defense Logistics Agency
Director, Defense Mapping Agency
Director, Defense Nuclear Agency
Director, National Security Agency
 Inspector General, National Security Agency
Director, On-Site Inspection Agency
Director, Joint Staff
Director, American Forces Information Service
Director, Office of the Civilian Health and Medical Program of the Uniformed Services
Director, Defense Prisoner of War/Missing in Action Office
Director, Defense Technology Security Administration
Director, Department of Defense, Dependent Schools
Director, Section 6 Schools
Director, Office of Economic Adjustment
Director, Washington Headquarters Services
President, Defense Acquisition University
President, Defense Systems Management College
President, Uniformed Services University of the Health Sciences

Non-Defense Federal Organizations

Office of Management and Budget
National Security and International Affairs Division, Technical Information Center,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on National Security
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight

Part III. Management Comments

Under Secretary of Defense (Comptroller) Comments



OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



AUG 4 1995

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE DOD INSPECTOR GENERAL

SUBJECT: Draft Audit Report on Major Accounting Deficiencies in the Defense Business
Operations Fund in FY 1994, Dated June 30, 1995 (Project No. 4FH-2010.01)

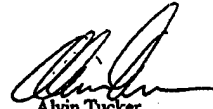
Thank you for the opportunity to comment on the subject report. The report fairly presents, on balance, conditions that existed within the Defense Business Operations Fund (DBOF) during the period in which the audit was conducted.

The Department, as a whole, has been undergoing fundamental changes in its effort to reengineer financial operations. The creation of the Defense Finance and Accounting Service (DFAS), with its capitalization of accounting services and personnel formerly belonging individually to the Military Departments and Defense Agencies, was an essential step in this improvement. The creation of the DFAS permitted a consolidation of accounting services and financial systems within five DFAS regional centers and 21 operating locations that otherwise would not be possible. This consolidation has been a difficult but necessary process that made visible the many inconsistent accounting policies, procedures, practices, and systems that previously were not known. This visibility permits improvement. However, as the report notes, the loss of experienced personnel due to downsizing has added to the time required to implement needed improvements and enhancements.

Nevertheless, significant improvements have occurred. First, although the loss of experienced revolving fund personnel has resulted in a learning curve for the DBOF that otherwise would not have been as severe, our new personnel are performing admirably. Their past and varied experiences, combined with growing DBOF experiences, are resulting in improvements visible within the DBOF at all organizational levels. Another significant improvement was the December 1994 release of Volume 11B of the "DoD Financial Management Regulation." That Volume, a compilation of previously existing and new accounting guidance, was developed specifically for the DBOF and has been distributed to all DBOF field installations. Potentially, the most significant improvement was the preparation, commencing in January 1995, of monthly financial statements for all elements of the DBOF. These monthly financial statements are in a similar form, and have the same content, as the annual financial statement prepared under the Chief Financial Officers Act. Additionally, the monthly financial statements are verified for accuracy by the DBOF activities prior to release. This new reporting process should improve substantially the accuracy and timeliness of financial information presented to DoD managers. This new monthly financial report would not be possible without the DFAS consolidation and the guidance contained in Volume 11B.

Under Secretary of Defense (Comptroller) Comments

I sincerely appreciate the assistance of the Office of the DoD Inspector General and the audit agencies of the Military Departments in the continuing improvement of the DBOF. My staff contact is Mr. Thomas Short. He may be reached on (703) 697-6875.



Alvin Tucker
Deputy Chief Financial Officer

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Russell A. Rau
Frederick J. Lane
Raymond D. Kidd
John M. Seeba
David W. Alekson
Rodney E. Lynn
Mary E. Vitale
Stephen C. Borushko
James F. Degaraff
Andrew W. Repak
Kimberly V. Stafford
Susanne B. Allen
Judy L. White

INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Major Accounting Deficiencies in the Defense Business Operations Fund in FY 1994

B. DATE Report Downloaded From the Internet: 01/06/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #):
OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ Preparation Date 01/06/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.